WHITE & CASE

TAX JOURNAL – TOGC & 'immediately consecutive transfers' of business

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VAT focus TOGCs and 'immediately consecutive transfers'

A transfer of a business as a going concern (TOGC) is, subject to conditions, outside the scope of VAT. HMRC takes the view that the TOGC treatment is not available where there is a series of immediately consecutive transfers of business. However, neither the UK TOGC legislation nor Article 19 of the Directive expressly provide for any such restriction. The authors contend that where all parties are fully taxable, if an intermediate owner (B) of a business (transferred from A to B and then from B to C) can demonstrate that it intended to carry on the business in the interim period between the transfers (and can evidentially demonstrate that such business was in fact carried on, practice being the best evidence of intention), then the UK VAT TOGC treatment should apply to both the transfers (provided that the other TOGC conditions are met) irrespective of what time period the business is carried on for by B.

It is not uncommon for assets to be acquired by one entity and then transferred shortly thereafter (by way of hive-out or hive-down) to an affiliate. This 'purchase and hive-out' acquisition structure is often undertaken for a variety of non-tax related reasons – for example, the exact business holding structure is not finalised by the purchaser group at the time of purchase or for TUPE requirements. In some cases, the seller may simply be reluctant to sell his assets to a newly incorporated company of the purchaser's group and may instead insist on an established company undertaking the acquisition.

Where the assets constitute a business or part of a business capable of separate operation, a fully taxable purchaser group would normally assume that both the transfer and the subsequent hive-out will obtain UK VAT transfer of going concern (TOGC) treatment. However, in such circumstances, the availability of the TOGC treatment is not free from doubt – it is HMRC's stated view that the TOGC treatment will not apply to 'immediately consecutive transfers' of business (*VAT Notice 700/9* para 1.2).

HMRC does not provide any guidance (or otherwise explain) what it means by 'immediately' in this context (nor for that matter prescribe a de minimis period for which the business in question must be operated). Furthermore, and confusingly for taxpayers, HMRC is understood to apply this 'immediately' restriction inconsistently and different HMRC inspectors have seemingly accepted different minimum lengths of time in different transactions as falling on the right side of the 'immediately' line. Unsurprisingly perhaps, in our experience, tax practitioners are often asked to advise on this area of UK VAT law.

This article considers the EU and UK legislative basis for this 'immediately consecutive transfers' restriction applied by HMRC to the availability of the TOGC treatment where all parties to the transaction are fully taxable persons, and concludes that if an intermediate owner of a business (transferred from A to B and then

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B to C) can demonstrate that it intended to carryon the business and, in fact, did carry on the business before its subsequent transfer, then the TOGC treatment should apply to both of the transfers, ie, from A to B and then from B to C (provided that the other conditions are met) irrespective of what time period the business is carried on for by intermediate owner of the business. This article does not consider the application of UK TOGC rules where consecutive transfers involve UK real estate or a VAT group.

TOGC treatment as prescribed by the EU directive

Article 19 of Directive 2006/112/EC (the Directive) sets out the EU framework for the TOGC treatment:

'In the event of a transfer, whether for a consideration or not or as a contribution to a company, of a totality of assets or part thereof, Member States may consider that no supply of goods has taken place and that the person to whom the goods are transferred is to be treated as the successor to the transferor.

Member States may, in cases where the recipient is not wholly liable to tax, take the measures necessary to prevent distortion of competition. They may also adopt any measures needed to prevent tax evasion or avoidance through the use of this Article.'

It is arguable that the structuring of Article 5 is inconsistent with the Directive

Article 29 of the Directive extends this principle to services.

The first paragraph of Article 19 of the Directive is unconditional, ie, it provides for a transfer of a totality of assets or part thereof to be treated as a non-event for the purposes of VAT without any conditions prescribed for this treatment to apply. EU case law has confirmed that 'totality of assets or part thereof' in this context refers to more than transfer of a collection of assets but to 'a coherent body of assets capable of allowing the pursuit of an economic activity, even if that activity forms only part of a larger business from which it has been detached'.

The purpose of the second paragraph of Article 19 is to allow Member States to make provision for cases where the transferee does not have a full right to recovery of VAT or to prevent tax evasion or avoidance.

Neither the UK TOGC legislation or Article 19 of the Directive expressly provide for any such 'immediately consecutive transfers of business' restriction

The policy rationale for the unconditional nature of the first paragraph of Article 19 (as stated in *Bulletin of the European Communities, Supplement 11/73*, at p 10) is to ensure that 'transfer as a going concern' provisions 'facilitate transfers of undertakings or parts of undertakings by simplifying them and preventing overburdening the resources of the transferee with a disproportionate charge to tax which would in any event be ultimately recovered by deduction of input tax paid'. As the CJEU observed in *Zita Modes Sarl v Administration de l'enregistrement et des domaines* (Case C-497/01), this provision ensures (and requires) that its application should lead to exactly the same result whether the VAT is charged by the transferor and then deducted by the transferee or whether the transaction is not taxed.

The UK's implementation of Article 19

The UK has implemented Articles 19 and 29 of the Directive by making the TOGC treatment available (to taxable and non-taxable persons alike) on a conditional basis. The VAT (Special Provisions) Order, SI 1995I1268, Article 5 provides that the TOGC treatment will be available where:

- a business as a going concern is transferred; and
- a number of conditions (set out below) are met.

These conditions are that:

- the assets of the business are to be used by the purchaser in carrying on the same kind of business as the transferor;
- where the seller is a taxable person, the transferee must be a taxable person already or become one as a result of the transfer;
- in respect of land which would be standard rated if it were supplied, the transferee must notify HMRC of an option to tax in relation to the land by the relevant date; and must notify the transferor that his option has not been disapplied by the same date; and

- where only part of the 'business' is being sold, it must be capable of separate operation.

It is arguable that the structuring of Article 5 is inconsistent with the Directive (and may therefore be ultra vires) because it provides a 'conditional' TOGC treatment where a business as a going concern is transferred, rather than providing an unconditional TOGC treatment (consistent with the first paragraph of Article 19 of the Directive), with restrictions/conditions for its availability to non-taxable persons or where tax avoidance or evasion is suspected as permitted by the second paragraph of Article 19 of the Directive.

The purpose of this article, however, is to highlight a further 'restriction' which HMRC has sought to introduce into the UK TOGC regime without any express wording to this effect in UK legislation or the Directive.

'Immediately consecutive transfers'

In addition to the TOGC conditions outlined earlier above, HMRC states in the *VAT Notice 700/9* that: 'We see the main [TOGC] conditions as being ... there must not be a series of immediately consecutive transfers of "business"' (para 1.2).

Even allowing for the inconsistent UK implementation of the TOGC provision in SI 1995/1268, Article 5, neither the UK TOGC legislation nor Article 19 of the Directive expressly provide for any such 'immediately consecutive transfers' of business restriction to apply generally to the availability of the TOGC treatment. Furthermore, in the context of a fully taxable person acquiring the business and on-selling it to another fully taxable person, any VAT charged (but for the absence of TOGC treatment) would be fully recoverable in any case (ie, there can be no argument of any VAT avoidance here) – this restriction therefore runs directly contrary to the policy rationale behind the operation and availability of the scheme of TOGC.

HMRC provides a rather pedantic reason for this restriction by seeking to apply the UK TOGC legislation and EU case law almost literally. As outlined earlier, one of the TOGC conditions is that the assets constituting the business are to be used by the purchaser in carrying on the same kind of business as the transferor (but not necessarily identical post-*Zita Modes*). The CJEU has stated (in *Zita Modes*) that the transfers referred to in Article 19 of the Directive are to those in which the transferee intends to operate the business transferred and not simply to immediately liquidate the activity concerned and sell the stock.

HMRC argues that where A transfers a business to B and then B immediately transfers the business to C, the assets constituting the business have not been used by B at all (ie, B has carried on no business) and therefore B has no 'business as a going concern' to transfer to C. In such circumstances, there are in fact two separate transactions and neither is a TOGC. That sounds somewhat plausible. The uncertainty that faces the taxpayers is the notion or myth that in order to 'escape' this HMRC 'consecutive transfers' restriction, the business in question must be carried on by the intermediate purchaser (B in the example above) for some minimum period of time. This myth has been propagated in part by HMRC itself whose inspectors are understood to have (in the past) accepted different minimum lengths of time in transfers involving the same kind of business as sufficiently long to 'escape' this 'consecutive transfers' restriction.

In light of this, many tax practitioners in advising the purchasing group (including the intermediate purchaser) have (in the best interests of their clients who often do not want to get into prolonged dispute with HMRC on fully recoverable VAT) advised quite conservatively that they allow as much time as commercially possible between the purchase and any subsequent on-sale by the intermediate purchaser (B). Understandably it is difficult for any tax practitioner to advise on what de minimis time span will suffice for these purposes as the very concept of a de minimis time span is contrary to the legislative basis set out in the EU Directive and the UK legislation both of which merely require any purchaser (including the intermediate purchaser B in the example above) to intend to carry on the business that has been purchased by it.

HMRC seemed to indicate as much in the consultation it carried out post-*Zita Modes* in 2005 when, in response to a request by consultees that HMRC defines how long the purchaser must continue to run a business (acquired and on-sold by a purchaser) for there to be a TOGC, HMRC stated publicly that 'since Zita Modes the test is whether the purchaser intends to carry on the business he has bought. This test does not lend itself to a set timespan, because continuation can vary between different types of activity'. (*HMRC summary of responses: VAT – Transfer of a Going Concern* para 8 (August 2005)).

This indicates that HMRC will, in applying the TOGC treatment in cases where consecutive transfers occur, look to apply the '*Zita Modes test*' rather than requiring a minimum duration for which the business in question has been carried out by the intermediate purchaser (B in the example above).

Evidentially, a reasonable time span between transfers will assist the taxpayer in establishing the intent of the intermediate purchaser as will the nature of the business itself. Some businesses will lend more easily to the argument that they were in fact carried on in an intervening period between the purchase and onward sale by the intermediate purchaser (B in the example above). An intermediate purchaser may be able to demonstrate evidentially that a retail business purchased at a time when the business is open and trading was carried on in the intervening period (however short that period may be), while by contrast the intermediate purchaser may require a longer intervening period to demonstrate that a passive investment business he acquired was actually intended to be carried on in the intervening period. In a 'purchase and hive-out' situation outlined earlier in this article, this evidential burden should also be capable of being discharged if the intermediate purchaser can demonstrate that as a commercial matter it was intended (and commercially imperative) that the purchasing group carry on the acquired business without interruption or break.

The uncertainty that faces the taxpayers is the notion or myth that in order to 'escape' this HMRC 'consecutive transfers' restriction, the business in question must be carried on by the intermediate purchaser (B in the example above) for some minimum period of time.

In conclusion therefore, in the absence of tax avoidance or evasion, if the intermediate purchaser can demonstrate that he intended to carry on the business in the intervening period (and can evidentially demonstrate that such business was in fact carried on – practice being best evidence of intention), following *Zita Modes*, the availability of the TOGC treatment should not be compromised merely because an onward sale of the business so acquired was contemplated or undertaken within whatever period of time (provided that all other conditions of TOGC are met).

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